

2012

1000

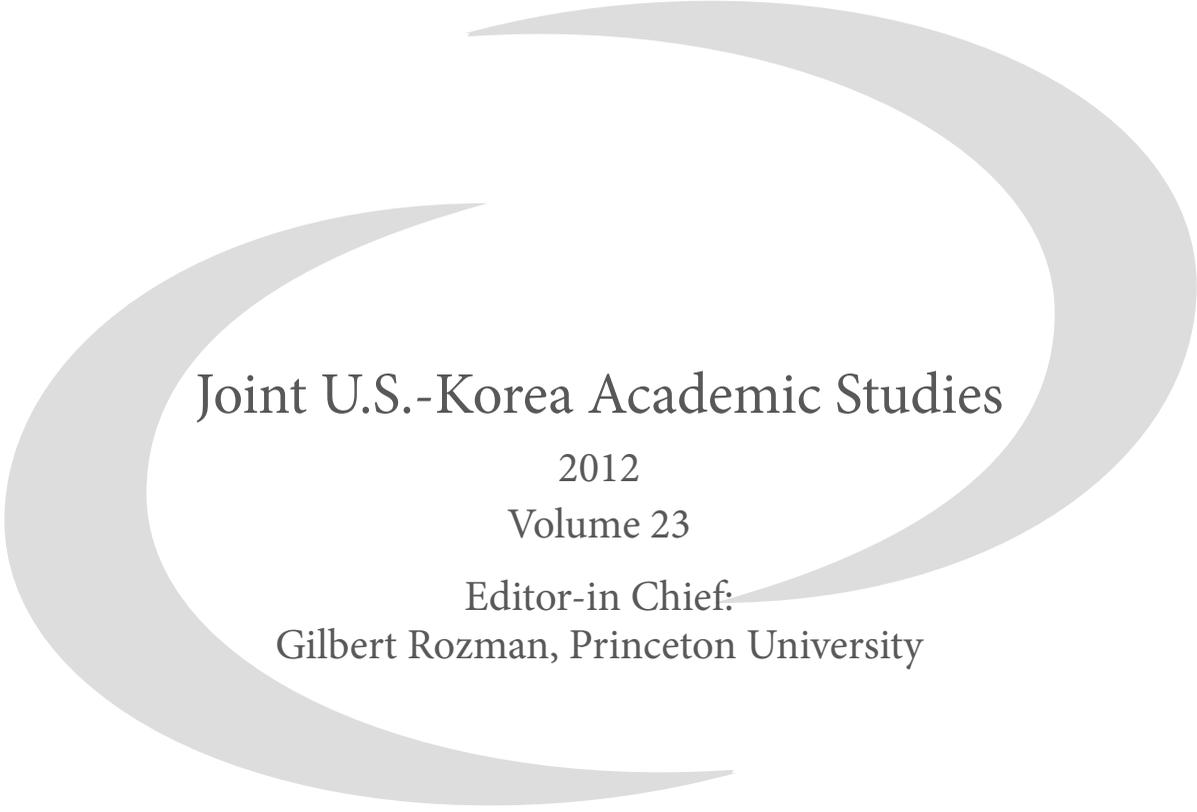
JOINT U.S.-KOREA ACADEMIC STUDIES

ASIA AT A TIPPING POINT:
KOREA, THE RISE OF CHINA,
AND THE IMPACT OF
LEADERSHIP TRANSITIONS

**EDITOR-IN-CHIEF:
GILBERT ROZMAN**

Vol. 23

 **KEI** KOREA
ECONOMIC
INSTITUTE
한미경제연구소



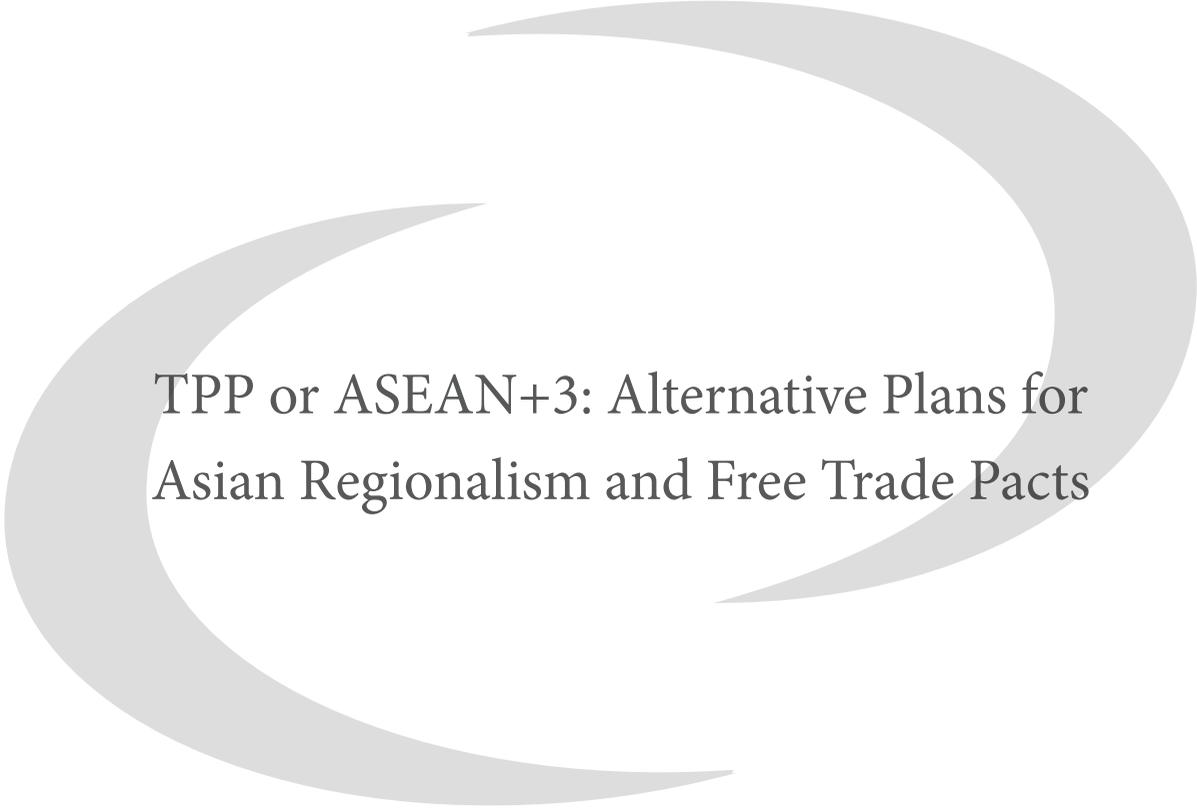
Joint U.S.-Korea Academic Studies

2012

Volume 23

Editor-in Chief:

Gilbert Rozman, Princeton University



TPP or ASEAN+3: Alternative Plans for Asian Regionalism and Free Trade Pacts

South Korea: Which Way Will it Go on Asian Integration?

HYUNG-GON JEONG

Since 1990, Regional Trade Agreements (RTAs), including Free Trade Agreements (FTAs) and Customs Unions, have spread rapidly on the basis of the WTO system that was launched in 1995; 224 FTAs were reported to GATT/WTO by late 2011, many of them in Asia.¹ Korea, China and Japan have already signed FTAs with ASEAN and individual ASEAN countries. The positive attitude of East Asian countries toward FTAs has contributed to trade liberalization in the East Asia region, and discussions surrounding ASEAN are becoming more active. Integration, however, is difficult to achieve due to the clash between China and Japan, the former hoping to pursue an East Asian FTA (EAFTA) within the ASEAN+3 (China, Japan, South Korea) framework; while the latter prefers a Comprehensive Economic Partnership in East Asia (CEPEA) within the ASEAN+6 (India, Australia, New Zealand) framework. Discussions entered a new phase as Japan, which has favored ASEAN+6, expressed its willingness to participate in TPP (Trans-Pacific Strategic Economic Partnership Agreement) at the APEC Summit in November 2011.

TPP was first launched by Chile, New Zealand, Singapore, and Brunei (Pacific 4 or P4) and has become one of the leading economic integration systems in the Asia-Pacific; the United States, Australia, Malaysia, Peru, and Vietnam are participating in the negotiations, while Japan, Canada, and Mexico have declared their interest. After President Obama's suggestion that South Korea and Malaysia join TPP, their responses are awaited. These recent trends may have a great impact on the future of East Asian economic integration. China, which has been supportive of ASEAN+3, is already shifting toward integration through ASEAN+6, as suggested by Japan. These changes in the trade environment will have significant influence on the future of the South Korean economy. Under the assumption that CEPEA of ASEAN+6 and TPP centered on the United States will clash, this chapter analyzes the effects the two systems would have on the Korean economy, and assesses which would be more desirable.

THE CURRENT STATUS OF ECONOMIC INTEGRATION IN THE EAST ASIAN AND ASIA-PACIFIC REGIONS

This chapter first compares the main economic indicators of CEPEA and TPP. In the analysis, TPP includes the P4, the five countries in negotiations (Australia, Malaysia, Peru, U.S., and Vietnam), those who expressed an interest in participating at the APEC summit in Hawaii (Canada, Mexico, and Japan), and lastly, South Korea. As shown in Table 1, ASEAN+6 accounts for 49% of the world population, which is considerably larger than the 12.1% in TPP. Yet, it only accounts for 27.4% of the world economy, which is much lower than the 41.2% of TPP. In world trade, it comprises 27.8%, while TPP has 29.3%.

Figure 1 shows intraregional trade shares of ASEAN+3, ASEAN+6 and TPP. The intraregional trade of ASEAN+3 and ASEAN+6 are steadily increasing. The figure for ASEAN+6 was 33% in 1990, but increased to 45.1% in 2010. The percentage of intraregional trade between TPP countries, however, dropped sharply from 54.7% in 1990 to 44.4% in 2010, yielding a lower trade share for those countries.

Figure 2 examines South Korea’s export share to each bloc. It continues to rise to ASEAN+3 and +6. In the early 1990s, its export share was 56.2% to TPP countries and 28.4% to ASEAN+6; however, in 2003 its exports to ASEAN+6 exceeded exports to TPP. In 2010, exports to ASEAN+6 reached 48.8%, while exports to TPP decreased dramatically to 28.4%.

Imports from ASEAN+6 were 36.3% of its total in 1990, which rose steadily to 52.4% in 2010, while imports from TPP dropped from 58.4% in 1990 to 37.6% in 2010. In comprehensive terms, trade between South Korea and ASEAN+6 increased from 32.5% in 1990 to 50.5% in 2010; on the other hand, trade between South Korea and TPP showed a sharp decrease from 57.4% in 1990 to 32.7% in 2010.

Table 1. Economic Indicators of Major Economic Blocs in the Asia-Pacific Region (2010)

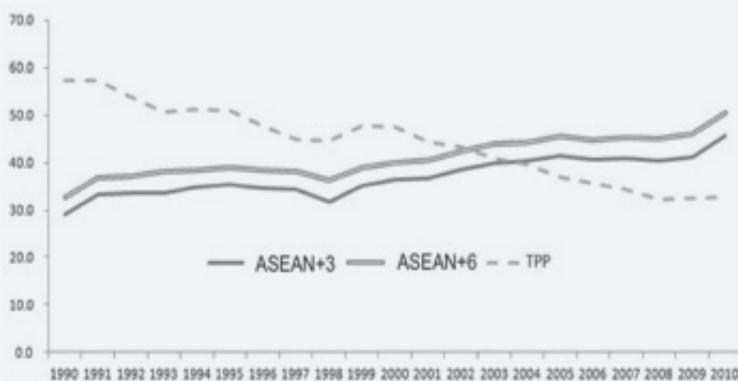
Economic Blocs	States		Population (Million)	Economic Scale (GDP) (Billion)	GDP per capita	Total Trade (Billion)
ASEAN+3	CJK	S. Korea	49	1,014	20,756	857
		Japan	1,341	5,878	4,382	2,974
		China	128	5,459	42,783	1,466
		Sub Total	1,518 (22.3%)	12,351 (19.6%)	8,136	5,297 (17.5%)
	ASEAN	Brunei	0	12	29,675	11
		Cambodia	14	12	814	14
		Indonesia	238	707	2,974	293
		Lao DPR	6	6	1,004	6
		Malaysia	28	238	8,423	416
		Myanmar	61	45	742	16
		Philippines	94	200	2,123	131
		Singapore	5	223	43,117	665
		Thailand	64	319	4,992	380
		Vietnam	88	104	1,174	164
Sub Total	598 (8.79%)	1,866 (2.97%)	3,120	2,096 (6.91%)		
Total		2,117 (31.1%)	14,217 (22.6%)	6,714	7,394 (24.4%)	
ASEAN+6	India		1,191	1,632	1,371	550
	Australia		22	1,237	55,672	426
	New Zealand		4	141	32,163	62
	ASEAN+3		2,117	14,217	6,714	7,394
	Total		3,335 (49.0%)	17,227 (27.4%)	5,166	8,432 (27.8%)

TPP	Brunei	0	12	29,675	11
	Chile	17	203	11,827	127
	New Zealand	4	141	32,163	62
	Singapore	5	223	43,117	665
	Australia	22	1,237	55,672	426
	Malaysia	28	238	8,423	364
	Peru	30	154	5,205	61
	USA	310	14,527	46,860	3,246
	Vietnam	88	104	1,174	153
	Canada*	34	1,577	46,303	817
	Japan*	128	5,459	42,783	1,466
	Mexico*	109	1,034	9,522	630
	S. Korea*	49	1,014	20,756	857
	Vietnam	88	104	1,174	153
	Canada*	34	1,577	46,303	817
	Japan*	128	5,459	42,783	1,466
	Mexico*	109	1,034	9,522	630
	S. Korea*	49	1,014	20,756	857

Note: 1) Numbers in parentheses indicate the percentage of the world total 2) Countries with an asterisk are prospective ones that are in negotiations for or considering TPP membership participation.

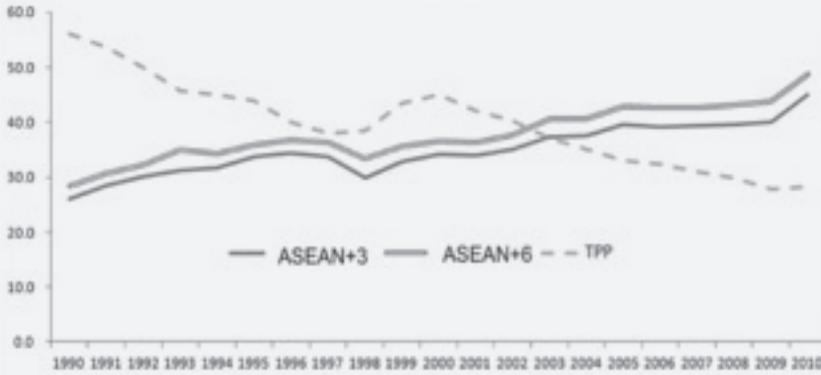
Source: IMF, World Economic Outlook [Online]; IMF, Direction of Trade Statistics.

Figure 1. Trends of Intra-regional Trade on a Regional Level



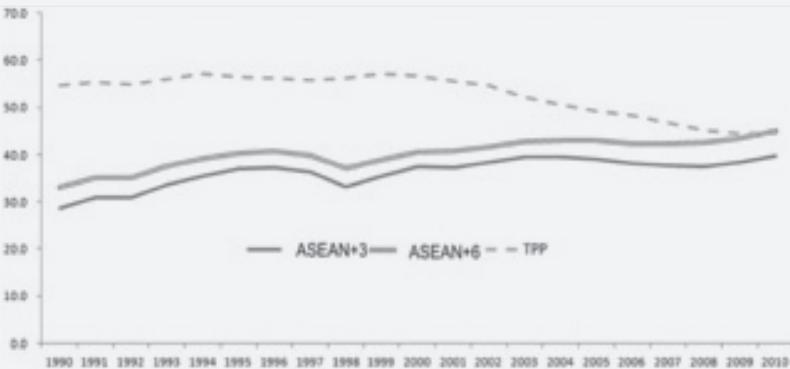
Source: IMF Direction of Trade Statistics. TPP member countries P4, five countries in negotiations (Australia, Malaysia, Peru, U.S., Vietnam), those who have expressed their willingness to participate at the APEC summit in Hawaii (Canada, Mexico, Japan), and South Korea.

Figure 2. Trends of Korea’s Intra-regional Export Share



Source: IMF Direction of Trade Statistics.

Figure 3. Trends of Korea’s Intra-regional Import Share



Source: IMF Direction of Trade Statistics.

SOUTH KOREA’S DECISION: ASEAN+6 VS. TPP

Comparing Macroeconomic Effects of CEPEA and TPP²

To determine which would be more beneficial for Korea, I compare TPP and ASEAN+6, estimating macroeconomic effects (real GDP growth and changes of welfare level) with the CGE model. This model incorporates interdependent individual sectors within the economy (such as production, consumption, and investment) and foreign sectors (imports and exports) and is used to estimate the ripple effects following changes in the global economic environment, such as the trade environment related to FTAs and DDAs, as well as climate change. This study uses the standard GTAP model, most commonly used of all CGE models, and the GTAP V 7.1 data. GTAP V 7.1 is based on data covering 2004; re-released in June 2010 with modified, complemented V7 content.

Table 2. Classification of States	
	Country
1	S. Korea
2	China
3	Japan
4	United States
5	EU (27 Countries)
6	ASEAN
7	India
8	Rest of the World (ROW)

Basic Assumptions of the CGE

For this analysis, countries will be classified into Korea, TPP participants or those considering participation (twelve countries), and remaining ASEAN countries, the United States, China, Japan, India, the EU, and others. Analysis proceeds under the assumption that the KORUS and Korea-EU FTAs have taken effect.

For convenience and reliable results, industries are classified into 1) rice, 2) grains, 3) other agricultural products, 4) manufacturing and 5) services. Due to its sensitivity, rice has been exempt from concessions in all signed FTAs; therefore it is classified separately from grains. In grain imports, Korea applies quota tariffs and, when necessary, adjusts the volume of market access, so the actual tariff rate may be lower than what is indicated on the GTAP data. Everything considered, the range of tariff reductions is assumed to be around half the product. Because this analysis shows macroeconomic effects and analyzes various forms of FTA, simplified industrial classification is applied. KORUS and Korea-EU FTAs are assumed to be in effect, while FTAs signed with countries directly involved in TPP and ASEAN+6 are assumed to be newly upgraded as agreements come into effect. Commodity markets are assumed to be open-ended; however, the rice market of Korea and Japan is assumed to be closed. Service Tariff Equivalent has not been considered. Production input has been divided into five categories: land, low-skilled labor, skilled labor, capital, and natural resources. Classification of inputs complies with default configuration given by the data. While land is not transferable and natural resources also have transfer limitations, low-skilled and skilled labor, and capital have been set to move freely between industries. Factors of production can move between industries, so changes in domestic production in accordance with tariff reductions are possible. However, the GTAP model does not assume that factors of production are transferable between countries; therefore, movement of labor and resources between countries cannot be considered.

The East Asia FTA and TPP in this CGE analysis assume the model of capital accumulation. The capital accumulation model supposes that the short-term economic gain from an FTA draws investment and savings, leading to additional accumulation of capital that works as one of the main production factors, and is mostly used to analyze economic expansion effects from the FTA. It is highly

possible that an East Asian FTA will be pursued not simultaneously, but in a step-by-step process based on a long-term perspective, so it is advisable to use the capital accumulation model, rather than the static model, for analyzing mid to long-term effects. Furthermore, considering that the static model only takes the increase of domestic production from tariff reduction into account, it is likely that the possibility of varying ripple effects depending on various industries will be overlooked. In some industries, the effects of tariff reductions are quick, making capital accumulation possible as soon as the FTA enters into force; on the other hand, other industries may not even register any effects of tariff reductions. Therefore, short-term effects will only reveal limited significance. Also, because the economic effects of an FTA reinforce the fact that reinvestment leads to activation of industries, the capital accumulation model is deemed more reasonable compared to the static model.

Table 3. Economic Integration Perspectives		
Scenarios	Details	
East Asian FTA ASEAN+CJK+India, Australia, New Zealand	Refer to KORUS (Korea-USA) FTA	100% import tariff elimination
TPP (13 States)	Refer to KORUS (Korea-USA) FTA	100% import tariff elimination
Note: The rice market has been exempt from tariff cuts. Korea's grain tariffs for China and Australia, the agricultural tariffs of the Korea-India CEPA, etc. have been considered.		

Table 4 compares the expected economic effects depending on whether Korea signs an FTA with ASEAN+6 or TPP countries. It can expect 2.69% in actual GDP growth when an FTA is signed with ASEAN+6, while expecting 1.44% in actual GDP growth when signing with TPP countries. Moreover, in welfare changes, Korea can expect a profit of \$16.571 billion, while in the case of TPP, Korea can expect \$7.787 billion. In conclusion, the economic effects of ASEAN+6 are larger than that of TPP from Korea's perspective because trade liberalization with China, one of Korea's largest trade partners, has been considered. It is necessary to compare the relative size of expected FTA effects, rather than the effects driven by FTA, and to observe the direction of economic effects. Furthermore, the absolute value of figures resulting from this analysis may be prone to change, due to the gap between model assumptions and actual negotiations.

The CGE model may not reflect qualitative changes due to shifts in the trade environment and the effects of non-tariff barriers because it is centered on changes in tariffs, domestic production, exports and imports, and other quantitative changes. Because this CGE model utilizes the GTAP DB Version 7.1, it is unable to reflect the changes in East Asian and global trade environments after

Reference to KORUS & Korea-EU FTA	100% import tariff elimination	
	Impacts (%) on Real GDP	Changes in Welfare
		(100 Million US\$)
ASEAN + 6	2.69	165.71
TPP	1.44	77.87

Note: The effects of FTA signed by Korea, China, and Japan with ASEAN individually have not been taken into account.

2004. Although GTAP DB 7.1 has been released with partial modifications made on GTAP DB Version 7, it still relies on data from 2004; therefore countries like China that have continuously registered high economic growth exceeding 10% annually have not been taken into account, nor does it show the effects of the 2008 financial crisis.

CAN TPP BECOME A HIGH STANDARD FTA THAT LEADS THE GLOBAL ECONOMY?

Although the GDP size of TPP member countries is greater than that of ASEAN+6, TPP's reliance on regional trade shows a downward trend, while ASEAN+3 and +6 show a stable increase. ASEAN+6's reliance on regional trade is higher than that between TPP members. Mutual trade between East Asian countries is higher than trade with countries outside the region. Even in the case of Korea, exports and imports to and from ASEAN+3 and ASEAN+6 continue to increase; however, trade with TPP member countries is in continuous decline. Furthermore, the expected economic effects from ASEAN+6 are larger in the CGE model analysis. Pursuing cooperation with ASEAN+6 seems to be more desirable. However, if TPP is signed on a higher level than the present KORUS FTA, and is concluded as a high standard FTA that will lead the global economy, than Korea must consider TPP participation. Thus, the following sections examine if TPP can pursue the trade liberalization process left unfinished at APEC, conclude a high standard FTA, and lead to new global economic norms.

Countries are adopting a quantitative approach in measuring the level of trade liberalization, deeming that more than 90% of the total trade share between countries sharing an FTA needs to be open, in order for it to be considered trade liberalization. If so, have the P4—who are the founding members of TPP—opened more than 90%; has their agreement reached a higher level of trade liberalization than bilateral FTAs signed with other countries regarding tariff and non-tariff barriers and the service sector; and does their agreement show higher standards compared to the U.S.-led negotiations with P4+?

P4 countries have been more positive towards opening their markets than they were when they each signed bilateral FTAs as individual countries. Some scholars argue that because Singapore, Brunei, and New Zealand took an active open-door policy even before P4 negotiations, in reality, economic gains acquired through participation in P4 were not great. This argument makes sense, considering that Singapore had already abolished tariffs on most of its imports; that Brunei, as a small

country, imports little and depends on Singapore for most of its imports; and that New Zealand had already achieved a high level of trade liberalization even before joining P4. However, Chile was able to achieve market opening. For example, in its FTA with Canada and Australia, Chile excluded dairy products from target items; however, in the agreement with New Zealand it abolished 100% of its import tariff, regardless of the fact that New Zealand is an agriculturally advanced country. Chile has also adopted very open policies toward P4 countries with respect to reducing import tariffs. Furthermore, in the FTA with Canada (CCFTA) signed before P4, Chile only selected around 75% of total imports from Canada as customs-free items, but it liberalized imports for 89.3% of items from New Zealand and Singapore.³ In addition, at the TPP P+ negotiations with Australia, Chile agreed to import 96.9% of import items customs-free.⁴ With Canada, Chile also set fifteen years as a grace period regarding the phased tariff reduction after the FTA entered into force, while it set ten years as a transition period for New Zealand (six years for Australia).

If P4 countries are contributing more to mutual trade liberalization by lowering tariffs compared to other FTAs, are they also pursuing trade facilitation policies by eliminating non-tariff barriers? GATT Art. XXIV (b) clearly states that in order to truly liberalize trade, ORRC (Other Restrictive Regulations of Commerce) must be abolished. The P4 Agreement, Article 3.8, contains the following phrases, “in accordance with its rights and obligations under the WTO Agreement” and “in accordance with other provisions of this Agreement,” a reminder that other measures can be taken between member countries apart from trade remedy measures fixed by the WTO. Singapore, Brunei, and New Zealand have not applied any strong trade remedy measures to any trade partners, which shows that the level of openness is relatively high even in the aspect of non-tariffs. Recalling that Chile has overused these measures toward countries except for the P4, it can be said that Chile is not doing so because trade between countries is small, and has determined that even if such a system were abolished, the negative impact on the economy would not be great.⁵ In any case, the fact that trade remedy measures are applicable between member countries when FTA goes into force means that restrictive measures can be taken in future intra-P4 trade; but they may be ambivalent, knowing it might inhibit trade liberalization.

As mentioned earlier, GATS Article V implies trade liberalization regulations in service trade; however, the statement is also vague as to what is stated in the commodities sector. Only Singapore, Chile, and New Zealand out of P4 agreed to liberalize trade in services when the P4 Agreement was concluded, while Brunei agreed to submit a schedule for liberalizing the services trade to its trade partners within two years after the Agreement goes into effect. But Brunei has still not turned in the corresponding agreement, which means that P4’s FTA agreement has not achieved the rules of substantial sectoral coverage explicitly stated in GATS. It is noteworthy that the three countries, excluding Brunei, put conditions of trade in services on the “negative list,” which shows that even if they seem completely open on the surface, they are actually adopting rather strict conditions, as seen in Article 12.8. They ruled out opening up various services provided by the government, such as air transportation and financial services. In the case of Singapore, the article on services contains relatively relaxed conditions compared to

those of FTAs concluded with other nations; but it adopted rather strict regulations compared to the case of the U.S.-Singapore FTA. In its FTA negotiations with the United States, Singapore fully agreed to open financial, recreational, cultural and sports, transportation services, etc. Likewise, even in the service sector, P4 countries are showing ambivalent attitudes. It is still subject to debate whether they have achieved substantial sectoral coverage pursued by GATS.

In general, P4 takes more liberal policies compared to other FTAs, but also betrays strong protectionism in some parts due to the interests of each P4 country. However, in order to establish a new world economic order, the TPP Agreement should be a model for future FTAs, by further strengthening current trends in liberalization. TPP has expanded into an economic integration system, which contains nine countries total including the main countries of the Asia-Pacific region; the United States, Australia, Peru, Vietnam, and Malaysia; newly joining the early member states of P4. The concern is now whether the five additional countries will be able to conclude a high standard FTA that is more open than the P4 Agreement and includes the aforementioned contents. Let us look at the feasibility of TPP, by examining the main issues discussed in the TPP negotiations involving the United States, and the position of each participating country on each issue.

The Position of the United States

The United States is promoting TPP participation policies in earnest, as an alternative to the stalled discussions on the FTAAP through APEC and as a platform for the transition to FTAAP. Negotiating through twenty-four working groups, the United States aims to introduce the Platinum Standard that covers all the items above.⁶ Many of the regulations that were not able to be included in existing FTAs, such as indiscriminate elimination of tariffs on agricultural products, intellectual property rights, labor, environment, rules of origin, settlement for investor-state dispute, and articles related to competition (linked to SOEs) have been included in the TPP negotiations. One of the reasons why the United States started to take an interest in TPP is because the P4 Agreement included many of the conditions it supported during the process of negotiating FTAs. Furthermore, Chile and Australia—who have recently concluded bilateral FTAs with the United States—were participating in the TPP negotiations; so the United States wants to promote additional negotiations on issues that are sensitive, within a multilateral framework.

Out of the twenty-four items under negotiation shown in Table 5, items that are controversial include: dispute resolution, competition-related provisions, rules of origin, indiscriminate tariff abolition including agricultural products, and strengthening of intellectual property rights.⁷ Settlement of investor-state disputes refers to a system in which disputes between foreign investing companies in markets and local governments are filed at the International Court of Justice. Australia and New Zealand are reluctant to accept due to concerns about U.S. superiority in legal know-how, while the United States is opposed to an internal bilateral dispute between a company and local government settled by a third party. The competition provision is an article aiming to regulate unfair actions of state-owned companies to ensure fair competition between the public

Table 5. Twenty-Four Negotiation Items on the TPP	
Main Agendas	
Chief negotiators' meeting	
Market access (goods)	Services (Free trans-border mobility of service industries)
Market access (Fabrics/clothes)	Services (Finance)
Market access (Agricultural products)	Services (Communications)
ROOs (Rules of Origin)	Services (Free trans-border mobility of supply chains & management skills)
Additional measures for Trade Facilitation	E-commerce
Sanitary and Phytosanitary Measures	Investment
TBT (Technical Barriers to Trade)	Environment
Trade Protectionism (Safeguard, etc)	Labor issues
Government Procurement	Issues on various organizations
IPR (Intellectual Property Rights)	Dispute settlement
Fair competition-related clauses	Cooperation
Crosscutting issues	
Source: "Japan Looks to Trans-Pacific Partnership to Transform its Economy," JETRO, Feb. 2011, cited from the ministries of foreign affairs, trade, economy and industries of states participating in the TPP.	

and private sector. This is a provision that countries with a relatively large public sector, such as Malaysia, Vietnam, and Brunei, are against. It specifically targets China's future participation in TPP, and is expected to be a huge burden on China, which has many large public companies. Rules of origin is a provision causing the sharpest controversy between those that suggest consistent across-the-board rules of origin, and those that argue that the rules of origin in existing FTAs should not be invalidated. There are also concerns that goods linked to multiple countries cannot receive protection from TPP if across-the-board rules of origin were to be introduced. Indiscriminate abolition of tariffs including agricultural products is also intertwined with the interests of each country. The United States is insisting on complete abolition of tariffs on commodities by the end of 2014. Yet, the U.S. logic is unjustified because it has so far been persistent in claiming the permanence of the U.S.-AUS FTA and the U.S.-New Zealand FTA, which have helped to achieve a status quo of tariffs on American sugar and dairy products. The participation of Japan in TPP negotiations is expected to make settlement even more difficult. Due to stiff opposition from its own farmers, Japan will try

its best to protect its agricultural sector, complicating U.S.-led negotiations. On intellectual property rights, the United States is expected to seek application of the IPR article that was concluded in the KORUS FTA. The IPR provision in the KORUS FTA is an enhancement of the May 10th Agreement between former President Bush and the Democratic Party, aimed at strengthening property rights, particularly in the pharmaceutical industry.⁸ If the May 10th Agreement allows the production of generic drugs in developing countries, the new provisions prohibit it. Insertion of this provision is controversial, even in the United States, between generic drug manufacturers and pharmaceutical companies.⁹

Following are the reasons why the United States is trying to include such a wide range of items all at once. First, it wants to send a message that through an across-the-board conclusion that the TPP may have export inducement effects compared to existing FTAs, leading to a positive impact on domestic employment and income enhancement. Ron Kirk, the U.S. Trade Representative (USTR), argues that TPP “should function as a new trade system in the 21st century” that embodies high standards of providing new market approach opportunities to American workers, farmers, service providers, and small business owners. Through this the U.S. administration expects to draw out political support from small to mid-sized businesses and labor unions that have been relatively disadvantaged by existing FTAs.¹⁰ Second, the United States wishes to become the new center of the Asia-Pacific economic community through the achievement of the Platinum Standard, containing China, which is trying to achieve East Asian economic integration by excluding it through ASEAN+3 and +6, and using the expansion of TPP as a basis for negotiations with countries outside the region.¹¹ It aims to provide a reference point that is capable of inducing transformation in China’s trade and industrial structure and drawing China’s large state-owned companies into a competitive market system.¹²

American media perceptions about the U.S. government participating in TPP are not wholeheartedly positive. The U.S. auto industry is opposed to Japan’s participation in the TPP, while its meat and dairy industries show deep concern over meat and dairy products imported from agriculturally strong New Zealand. Furthermore, the media warn that fully opening the sugar industry during individual negotiations with Australia will invite strong opposition from the American sugar industry and distrust of the government. The United States tried to proceed with TPP formation through bilateral negotiations with countries that have not yet concluded FTAs at the second TPP negotiations amongst eight countries held on June 14-18, 2010 in San Francisco. However, such plans hit a wall when Australia, New Zealand, and Singapore sought unified regulations through multilateral negotiations. The United States has expressed this position because it has already signed individual FTAs with five out of the eight countries; so concluding FTAs with New Zealand, Brunei, and Vietnam, would create more favorable circumstances to enter the TPP economic bloc. Other countries strongly opposed this.¹³ When the United States proposed to adopt the same contents as in the KORUS FTA, opposition from the P4 members indicated that negotiations would not be easy.¹⁴

The Position of Japan

Kan Naoto concluded the “Basic Policies on Comprehensive EPA” on November 9, 2010, and soon after, officially declared active participation in TPP negotiations at the APEC General Meeting held in Yokohama.¹⁵ Japan’s strategy is completely different from its existing FTA strategies. Full elimination of tariffs on all commodities and services is a basic premise in TPP, and signifies a full opening of the agricultural market it has sought to protect so far.¹⁶ Voices in support or opposition, including those in the DPJ, stand in stark contrast. Surveys predicted that if Japan does not participate in TPP and the Korea-China FTA is concluded, its GDP is expected to decrease by 10.5 trillion yen. Other results suggested that total GDP will decrease by 7.9 trillion yen, due to reduced production in agriculture and fisheries, if Japan participates in TPP.¹⁷ The ruling party, however, wants to promote TPP participation in earnest, even if it means enduring extreme internal resistance and political pressure.¹⁸ There are three main reasons behind this persistence: to accelerate opening of the Japanese economy, to create momentum for reform of Japan’s industrial structure (especially in the agricultural sector), and to acquire a leading position in future discussions on East Asian economic integration vis-à-vis Korea and China.

First, Japan is planning to use participation in TPP as a platform towards an “Open Japan.” Kan argued that a new growth engine is necessary to overcome the domestic market-oriented economic system that is becoming permanent, and the situation in which Japan is far removed global economic trends.¹⁹ Moreover, as it can be understood from Table 6, Japan regards participation in TPP as a strategic means to revitalize the economy and also go beyond a simple FTA.²⁰ In the meanwhile, considerable damage to Japanese exports to the EU and the United States is expected due to the recently concluded Korea-EU and KORUS FTAs.²¹

	Japanese goods (Tariff rate %)	Korean goods (Tariff rate %)
US Market	Passenger cars (2.5%)	Tariff abolition within ten years of activation of KORUS FTA
	Polystyrene-Polyester (6.5%)	
	LCD screens-Color TV (5%)	
	Electrical amplifiers-speakers (4.9%)	
EU Market	Passenger cars (10%)	Tariff abolition within five years of activation of Korea-EU FTA
	CLBS TV (14%)	
	Liquid crystal display screens (14%)	
	Microwaves (5%)	

Source: Sun-Taek Hwang, “Japanese FTA Policies and Possibility of TPP Participation,” (Seoul: 2011, in Korean).

Second, Japan sees an opportunity to change its industrial structure, drastically reforming the agricultural sector that has relied on government subsidies for a long time. The government has been adhering to basic policies of FTA promotion enacted in 2004, which excluded the sensitive agricultural sector and focused on industrial products.²² However, Japan determined that full opening is inevitable once it starts participating in TPP, and focuses on “enhancing competitiveness and expanding foreign demand” and boosting the potential of Japanese agriculture as key challenges.²³ It referred to an “agricultural structure reform headquarters” in the “EPA Basic Policy” issued in November 2010, and plans to engage in proactive countermeasures, including basic policies for agricultural reform, finances, and mid to long-term action plans by November 2011.²⁴ Noda Yoshihiko cannot escape internal resistance, stating that he will “try his best to achieve what is in the best interest of the nation.” Yet, a passive attitude due to conscious awareness of domestic opposition directly contradicts indiscriminate market opening that the United States is demanding, making it unlikely that Japan will be able to fully and immediately participate in TPP. If there is a shift in U.S. intentions in order to expand its influence in Asia, this could make it possible for Japanese attitudes to soften and lead to unexpected progress.²⁵

Third, Japan recognizes TPP as a strategic opportunity to check future expansion strategies of Korea and China, and to occupy a leading position in East Asian economic cooperation. It intends to make these views known by participating in the establishment of FTAAP standards, which is the ultimate goal of APEC and TPP. In other words, because TPP is already in the actual negotiating stage, unlike ASEAN+3 and ASEAN+6, which are still being conceptualized, there is a chance to prepare for launching other moves at economic integration. Japan also determined that TPP participation would re-consolidate its alliance with the United States. This line of reasoning is one of the factors that enhances the chances for TPP conclusion, coupled with the intentions of the United States to expand its influence in East Asia.

The Position of China

The discussion of East Asian economic integration is at a standstill with no significant progress, with Japan and China locked in leadership competition. From logic stemming from deep-seated Sinocentrism, China prefers autonomous interaction (ASEAN+3) in East Asia without interference from the United States. It expresses antipathy toward the U.S. push for TPP. Even though China already concluded FTAs with New Zealand and Singapore, bilateral FTAs between these countries led to no great increase in openness. The possibility of it joining the TPP cannot be ruled out, because the TPP members, including the United States, believe that any country should be able to participate freely if it simply accepts the level of market opening and trade/investment liberalization required.²⁶ In addition, the Chinese government is well aware that it needs to find a new road before China falls into a stagnation trap when its high growth winds down. But considering that it took a long time for China to open up to the WTO and that it has been severely criticizing the shortcomings of the American market economy, there is little likelihood that this will happen for a long time.²⁷

The form of economic integration that China prefers is the EAFTA. It may continue its overtures towards the region: strengthening cooperation via ASEAN+3 and accelerating regional economic integration that would not be different from a Korea-China FTA or China-Japan-Korea (CJK) FTA. China expects the CJK FTA to contribute to forming ASEAN+3 as a building bloc, because these three states have already concluded FTAs with ASEAN countries individually. As TPP discussions centering on the United States gather momentum, China is taking a rather flexible stance toward ASEAN+6, expecting to achieve integration that focuses on ASEAN. China is encouraging the start of negotiations for CJK FTA in earnest, and now displays a more positive stance toward the formation of ASEAN+6 that Japan has suggested.

CONCLUSION: PROSPECTS FOR TPP CONCLUSION AND KOREA'S DECISION

From Korea's standpoint, economic benefits are larger in ASEAN+6, which focuses on ASEAN, compared to TPP, which centers on Asia-Pacific countries. In addition, considering that the drive for future economic growth is bigger in the East Asia region, an ASEAN-oriented regional integration seems more desirable for Korea. Korea has signed FTAs with major TPP members (the United States, Chile, Peru, and Singapore), and is conducting FTA negotiations with Australia and New Zealand, so incentives for joining the TPP do not seem great. Of course, some argue that Korea should first join TPP, because ASEAN+6 has only just been conceptualized, while TPP is already at the negotiating stage. Moreover, TPP negotiations are expected to follow the standards of KORUS FTA, which includes all of Korea's sensitive issues, so there are arguments that Korea will not experience major difficulties after joining TPP.²⁸ However, the results of ongoing negotiations for the five latecomer countries in joining TPP, and whether or not Japan and China will join TPP, are more important factors.

It is unlikely that Japan will participate in TPP, but if the level of openness in TPP is high and Japan decides to join, then Korea's competitiveness, in comparison to that of Japan, may decline in the TPP member market. This means that Japan's participation would likely trigger Korea's participation in TPP. The level of openness in the agricultural market will play a prominent role in determining whether or not Korea will decide to join. Japan's level of openness in the agricultural sector, which is more closed than that of Korea, may also affect Korea's conditions and willingness to participate.²⁹

Whether or not China will join TPP will also become an important factor in Korea's decision. As seen in the CGE model, the biggest reason ASEAN+6 would bring more economic benefits for Korea is China. It is expected that China's position as a consumer market and producer will become stronger in the future, under the current global and European financial crisis. However, if TPP expands and Korea and ASEAN decide to join, a new market and production network will be formed within TPP, in which case China's position will be weakened in the mid to long-term. So China is expected to decide whether it will accept the expansion of U.S. influence toward East Asia in the short term and participate in TPP in the mid

and long term; or continue with efforts toward regional economic cooperation independently.³⁰ Such intentions are also expressed in China's official stance, stating that "it is somewhat unpleasant not having been invited to TPP discussions, but if the economic integration process is carried out in a transparent and fair manner, we will accept it." Furthermore, although it is hard for China to accept the across-the-board conclusion of multilateral negotiations according to the Platinum Standard, given concerns that it will fall into the middle-income trap, the possibility of China's participation in the mid and long term cannot be ruled out.³¹ If China's participation in TPP progressed rapidly, it is possible that Korea would fall behind and be left out of the bloc. However, it is much more likely that China will be active in organizing a China-led regional economic integration and discussing the CJK FTA, while engaging in efforts to bolster its relations with ASEAN. Korea is expected to respond positively to such efforts from China.³²

Another important factor in Korea's decision to participate in TPP is whether or not the TPP Agreement will be concluded under more favorable conditions than the KORUS or Korea-EU FTA in future negotiations between P+ member countries. This has to do with whether the sensitive parts of twenty-four detailed provisions, such as rules of origin and intellectual property rights, are more advantageous for Korea compared to the KORUS FTA. In particular, TPP is more favorable because it is more diverse in terms of developmental stages than the KORUS FTA, regarding the rule of origin. There is a debate in the KORUS FTA on whether the Kaesong Industrial Complex will be recognized as a processing zone outside of the region. In the case of rules of origin applied to outward processing zones, the concluding standards of each FTA are different and do not have clear criteria. Moreover, in the KORUS FTA, goods and parts produced in North Korea, including Kaesong, must receive approval from OFAC (Department of Office of Foreign Assets Control) in order for them to be applied to the KORUS FTA.³³ For the automotive industry that is expected to benefit the most from this FTA, it is necessary to keep an eye on the direction toward which the TPP rule of origin progresses, given the tens of thousands of parts needed in automobile manufacturing. KORUS FTA stipulates "to encourage producers that utilize parts, labor, and other production factors produced in Korea or the US, this FTA limits its applicable range to Korea and United States, excluding markets in North Korea, China, and other countries." Also, looking at the division of labor within East Asia, exporting Korea's manufactured goods may be a burden in the future.³⁴ Furthermore, if the rule of origin in TPP is concluded over-reciprocal to countries within the region, there is a possibility of Korea becoming a target of reverse discrimination from the countries within the TPP region, regardless of the KORUS FTA. However, such coordination of detailed terms only favorable towards countries within the TPP region must be preceded by concessions from the United States, which it will find difficult to accept.

The United States is taking the standards of KORUS FTA as a basic template, instead of existing standards of P4.³⁵ In fact, when the TPP is compared to the P4, it reveals that the divisions in negotiations for commodity trade have been divided into more specific areas such as agriculture, industrial products, textiles

and clothing. Things such as Yarn Forward regulation for textiles and clothing, as in the KORUS FTA, will be added to rules of origin; “service” was divided into finance, telecommunications, and e-commerce; and provisions on labor and environment have been added. This seems to be the intention of the United States to apply the same standard of intellectual property rights (IPR) in TPP, as they have demanded in the KORUS FTA.³⁶ The IPR in KORUS FTA focuses on pharmaceuticals; the KORUS FTA prohibits the manufacture and distribution of generic drugs within developing countries, that have been allowed to do so according to the May 10th Agreement established during the Bush Administration, upon agreement between the U.S. administration and Congress (the Democratic Party) at the time. In other words, the United States clearly specified a higher protection level of IPR than they did in the KORUS FTA.³⁷ Considering the position of the United States to apply such standards to TPP, mutual concession regarding the rule of origin seems difficult. Assuming this situation, the conclusion of TPP is expected to be more complex, in which case the goal of conclusion by 2012 will be difficult to achieve. Also, the aforementioned internal resistance within Japan and the government’s reserved negotiating attitude, will make conclusion of negotiations very difficult. Since there are big differences among TPP members in economic and institutional development, it will be difficult to conclude high quality FTAs. Within East Asia attitudes are polarized: South Korea, Japan, and Singapore are pursuing relatively advanced FTAs, while ASEAN and China are pursuing a low quality FTA.

It is expected that East Asian economic integration will grow more complex, as the positions of East Asian countries and the United States regarding TPP are not congruent. Korea has already effectuated FTAs with two giant economies, the United States and EU, so for the time being, the situation is not urgent with respect to TPP participation. Furthermore, it is unlikely that TPP will be actualized in a short period, and Korea has already concluded bilateral FTAs or is in the process of negotiation with the majority of the TPP participants, so it is all the more unnecessary to rush into joining the TPP. However, there is a subtle difference between bilateral and multilateral FTAs. In a world where the products and services of each country are made or are available only in a particular country, there will probably be no differences. But the global production network is expanding, and input from various nations is added between the start of manufacturing and the sale of the final product. This impacts production. In such a situation, multilateral FTAs, especially economic integration systems like TPP, between countries with various special advantages such as resources, labor, technology, and markets, are much more beneficial in satisfying the rules of origin, compared to bilateral FTAs. Korea should not rush in determining the pros and cons regarding TPP. It would be wiser to take some time in deciding, while examining the future agenda of TPP and the ongoing movements of China and Japan.

REFERENCES

1. World Trade Organization's Regional Trade Agreements Information System, <http://rtais.wto.org/UI/PublicAllIRTAList.aspx>.
2. The author would like to acknowledge the contribution of Dr. Hankyung Sung for the estimation of macroeconomic effects using the CGE model. The results of the CGE model are not the official position of KIEP, but are based on his 2012 paper.
3. Canada-Chile Free Trade Agreement (CCFTA), <http://www.agr.gc.ca/itpd-dpci/ag-ac/4957-eng.htm>.
4. Australia-Chile Free Trade Agreement, Summary of Key Obligations, http://www.dfat.gov.au/GEO/chile/fta/FTA_key_obligations.html.
5. Henry Gao, *The Trans-Pacific Strategic Economic Partnership Agreement: High Standard or Missed Opportunity?* (Bangkok: UNESCAP, 2009), p. 16.
6. C. Fred Bergsten and Jeffrey J. Schott, *Submission to the USTR in Support of a Trans-Pacific Partnership Agreement*, Peterson Institute for International Economics, 2010, pp. 2-3.
7. "Japan Looks to Trans-Pacific Partnership to Transform its Economy," JETRO, Feb. 2011, p. 61.
8. Compared to the May 10th Agreement, the IPR provision in the KORUS FTA strengthened several articles such as patent-product registration linkage (the Korean government is to suspend the approval process for generic drugs to prevent others from selling generic drugs without the patent owner's consent), Patent Term Extension (a patent term may be extended to compensate for unreasonable delays during prosecution), and Data Exclusivity (the provision allows data exclusivity for pharmaceutical products). The May 10th Agreement does not include such provisions to any significant degree.
9. Minerva Solis, "Last Train for Asia-Pacific Integration? U.S. Objectives in the TPP Negotiations", Waseda University *Organization for Japan-US Studies (WOJUSS) Working Paper, No. 2011-02*, (Tokyo: Waseda University, 2011), pp. 13-14.
10. C. Fred Bergsten and Jeffrey J. Schott, *Submission to the USTR in Support of a Trans-Pacific Partnership Agreement*, p. 2.
11. C. Fred Bergsten and Jeffrey J. Schott, *Submission to the USTR in Support of a Trans-Pacific Partnership Agreement*, pp. 9-16.
12. "Japan Looks to Trans-Pacific Partnership to Transform its Economy," p. 62.
13. Choi Won Gi, "The United States' Strategy for Building Trans-Pacific Partnership," IFANS BRIEF 2010-22, (Seoul: IFANS, 2010), p. 6 (in Korean).
14. Kwon S. H., "Japan's Discussion on Trans-Pacific Partnership and its Future Prospects," *International Economic Information* 2011-28 (Seoul: Bank of Korea, 2011), p. 3 (in Korean).
15. "Japan Looks to Trans-Pacific Partnership to Transform its Economy," p. 1.
16. Kim, Yang Hee. "An Analysis on Japan's EPA Strategy: Is Japan's Participation in the TPP Negotiation Possible?" *KIEP World Economy Update*, 2011, pp. 2-3 (in Korean).
17. Regarding the different estimated results, the Japanese government officially released its official results that the nation's real GDP would increase by 2.7 trillion yen, if Japan participates in the TPP negotiation. See the Korea-Japan Cooperation Foundation, "Implications on Japan's decision to join the TPP negotiation," *Japan Knowledge Report*, (Tokyo: Japan Information Centre, 2011), p. 3 (in Korean).
18. Choi, H. S., "An Analysis on Japan's Politics on TPP," *TPP KNSI REPORT 36* (An Analysis and Implications for TPP and East Asia)-1, 2011, p. 8 (in Korean).
19. East Asia Forum, "Three reasons why Japan should join the TPP", December 22, 2010. (<http://www.eastasiaforum.org/2010/12/22/three-reasons-why-japan-should-join-the-tpp>, accessed on January 4, 2012).
20. Hwang Soon Taik, "Japan's FTA Policy and Prospects for Joining TPP," IFANS BRIEF. 2011-34, 2011, p. 7 (in Korean).
21. Trade dependency of Korea on its FTA partners is in the mid-30%, while trade dependency of Japan on its EPA partners remains around 20%.

22. In addition, Japan tended to prioritize ASEAN over the United States on its trade policy. In 2009, the Hatoyama cabinet proposed ASEAN + 6 as a concept for an East Asian Community. In September, 2009, he did not include the United States as a member of the East Asian Community. See Kim Yang Hee, "New U.S. Strategy for East Asia and Japan's Strategy for the Trans-Pacific Partnership," *KNSI Special Report 36-2*, 2011 (in Korean).
23. Kim Yang Hee, "New U.S. Strategy for East Asia and Japan's Strategy for the Trans-Pacific Partnership," p. 4.
24. "New Prospects for Japan's Trade Policy and Implications for Korea," *KJCF 2011*, p. 103-04 (in Korean).
25. "New Prospects for Japan's Trade Policy and Implications for Korea," p. 108.
26. "New Prospects for Japan's Trade Policy and Implications for Korea," p. 105.
27. Kwon Hyuk Jae, "Prospects for Trans-Pacific Partnership," *SERI Economic Focus 359* (Seoul: SERI, 2011), p. 8-9 (in Korean).
28. Jeffrey J. Schott, "The Doha Dilemma: Implications for Korea and the Multilateral Trading System," prepared for the KITA-PIIE International Conference held on Sep. 26, 2011, p. 5.
29. Choi Sei Kyun, "Trans-Pacific Partnership Agreements: Results of Negotiations and Implications for Accession," *KREI*, 2011, p. 91 (in Korean).
30. Kim Hyung Joo, "Japan's Decision to Join the TPP negotiations: New Prospects on East Asia's FTA," *LG Business Insight*, 2011, p. 3 (in Korean).
31. "Don't Worry About China: World Bank Chief Economist", *Forbes*, December 25, 2011. <http://www.forbes.com/sites/gordonchang/2011/12/25/dont-worry-about-china-world-bank-chief-economist/>.
32. Hwang Soon Taik, "Japan's FTA Policy and Prospects for Joining TPP," p. 14.
33. Mark E. Manyin, et al., "Imports from North Korea: Existing Rules, Implications of the KORUS FTA, and the Kaesong Industrial Complex," *CRS Report for Congress 7-5700*, 2011, p. 14.
34. Mark E. Manyin, et al., "Imports from North Korea," p. 15.
35. Yang Hee Kim, "New U.S. Strategy for East Asia and Japan's Strategy for the Trans-Pacific Partnership," *KNSI Special Report 36-2*, 2011, p. 12 (in Korean).
36. Minerva Solis, "Last Train for Asia-Pacific Integration?" pp. 13-14.
37. Compared to the May 10th Agreement, the IPR provision in the KORUS FTA strengthened several articles such as patent-product registration linkage (the Korean government is to suspend the approval process for a generic drug to prevent others from selling the generic drug without the patent owner's consent), Patent Term Extension (a patent term may be extended to compensate for unreasonable delays during prosecution), and Data Exclusivity (the provision allows data exclusivity for pharmaceutical products).